



Uzbekistan Country Overview



BASIC FACTS:

Capital: Tashkent
Area: 447,000 square kilometers
Population: 24.4 million (1999)
Currency: Soum
Exchange Rate: \$1 = 353.67 soums (May, 2001)
GNP: \$17.6 billion (1999)
GDP Growth: 4.4% (1998); 4.4% (1999); 2.8% (1999-03)
GNP per capita: \$720 (1999)
Inflation: est. 29.0% (1998); est. 29.1% (1999)

EXECUTIVE SUMMARY

Uzbekistan has excellent long-term economic potential, because of its well-educated population and plentiful natural resources. It is the world's ninth largest producer of gold (with annual output of approximately 60 tons) and is among the world's ten largest producers of natural gas (with annual production of more than 50 billion m³). Although Uzbekistan's oil and gas production has increased in the past 10 years, its export potential is hindered by a lack of export routes from Central Asia.

Progress in systemic economic reform has been slow, in accord with President Karimov's commitment to gradual economic reform. But the government's reluctance to relinquish control of key sectors of the economy remains a serious impediment to the fulfillment of Uzbekistan's long-term economic potential. Uzbekistan's move in early 1999 to begin privatizing major enterprises is a positive sign for foreign investors, but there are many other hurdles to be overcome, such as the lack of a convertible currency, before Uzbekistan can become an attractive market for foreign trade and investment.

Recent economic performance has been poor. The cotton crop failed in 1998, and world gold prices declined. Monthly inflation rates accelerated in late 1998 to 40%. By 1999 the unofficial exchange rate for the dollar was nearly four times the official rate. Shortages of key imports have appeared. Meanwhile, social policy issues are being addressed as a priority, with reforms in health, education, pensions, and social security receiving most attention to alleviate weaknesses in the current systems.

The Government of Uzbekistan has stated that it is committed to a gradual transition to a free market economy, but its top priority is maintaining political stability. Much of the economy remains in state hands, with agriculture under tight state control. The government also pursues an import substitution policy by controlling access to foreign exchange. Uzbekistan's slow pace of reform has discouraged investment and led

international lending organizations to suspend or scale back credits. The government has made some progress in reducing inflation and the budget deficit, but government statistics understate both, while overstating economic growth. The government is taking some modest steps to reduce the formal and informal barriers that constrain the nascent private sector.

Political relations between the United States and Uzbekistan are strong, with close cooperation in foreign policy, security, antiterrorism, and anti-narcotics issues, and frequent high-level bilateral contacts. U.S. concerns about Uzbekistan's slow progress on democratic reform and its human rights abuses, as well as Uzbekistan's reluctance to undertake serious economic reforms, prevent the relationship from developing more fully, however. Uzbekistan's Constitution provides for a presidential system with separation of powers, freedom of speech, and representative government. In practice President Islam Karimov and the centralized executive branch that serves him dominate political life. President Karimov makes virtually all key decisions in the country, appoints and removes ministers and local officials at will, and clamps down on any opposition activity. The Oliy Majlis (Parliament) meets only a few days each year, and has little power to shape laws. Despite constitutional provisions for an independent judiciary, the executive branch heavily influences the courts in both civil and criminal cases.

The leading sectors for U.S. exports and investment are machinery and equipment for the food processing and packaging, textile, mining, energy and civil aviation industries, as well as information technology and communications.

ECONOMIC OUTLOOK

Uzbekistan has a well-educated population, and is rich in natural resources. It is the world's ninth largest producer of gold (with annual output of approximately 60 tons) and is among the ten largest suppliers of natural gas (with annual production of more than 50 billion m³). More than 20 percent of Uzbekistan's GDP is generated in agriculture, which employs about 40 percent of its labor force. Primary commodities, such as cotton fiber, mining and energy products, account for about 75 percent of its merchandise exports; cotton alone accounts for 40 percent of exports. Overuse of the rivers that feed the Aral Sea for irrigation of agricultural lands has already reduced it to two-thirds of its former size, however, and salinization of the surrounding area threatens the environmental and economic viability of the region.

Although Uzbekistan's long-term economic potential is strong, recent economic performance has been poor. In 1998 the cotton crop failed and world gold prices declined, contributing to a decline in exports estimated to have exceeded 17%. Immediately following the collapse of the Russian ruble in August of 1998 the parallel, or black-market, exchange rate depreciated significantly, but monetary authorities devalued the official rate only slightly. Instead, the Government kept the trade deficit from exploding by tightening import controls, with the result that imports declined by nearly 16%. Shortages of key imports appeared.

The price level by the end of 1998 was estimated to have risen by about 50% year-on-year, and monthly inflation figures began to accelerate by year-end, reaching 3.8% in November (implying inflation of 155% at an annualized rate). The Government's

reaction has been to accommodate price rises by increasing wages in July of 1998 and again in January of 1999. By February of 1999, the parallel rate had soared to 410 soums per dollar, as compared with an official rate of 112. The Government responded by increasing from 30% to 50% the proportion of foreign exchange earnings foreign companies were required to surrender at the official rate.

Although Uzbekistan's gas production has been increasing, its growing gas consumption has meant that the amount of gas available for export has remained relatively steady since 1998. Currently, Uzbekistan exports natural gas to Kazakhstan, Kyrgyzstan, Russia, and Tajikistan via the Central Asia-Central Russia pipeline. In an effort to expand and diversify its customer base for gas exports, Uzbekistan has sought to develop various alternative export routes which could allow it to expand its export to European markets, Pakistan, India and China.

Uzbekistan has implemented a relatively good small-scale privatization program, with 60,000 enterprises (96 percent of the total) having been privatized or leased to worker collectives since 1992. But progress in privatization of medium- and large-scale enterprises, and agricultural enterprises, has been on-again, off-again, with little real progress. In late 1998 the Government announced another ambitious program of privatization of many of its major enterprises.

BUSINESS AND INVESTMENT CLIMATE

Some of the most serious obstacles faced by foreign companies doing business in Uzbekistan center on import restrictions and currency convertibility restrictions, coupled with a recent increase in mandatory foreign exchange surrender requirements, as described in the previous section.

In addition, the Central Bank has begun sharply limiting the amount of cash soums in circulation and to require that virtually all transactions by enterprises, with the exception of wages and travel, must be paid by interbank transfers rather than in cash. The effect has been to make even day-to-day bank operations difficult and time consuming, because interbank transfers can take anywhere from several days to several months to clear. As a result, a parallel pricing system has formed in which the price for goods in interbank transfers is running as high as three times the cash soum price.

The overall effect of these measures on foreign trade and investment in Uzbekistan has been negative. Many major foreign companies are pulling out of or significantly reducing their activities in the Uzbek market. Over the past six months, major players such as Enron, Unocal and AIG have all substantially cut back on operations in Uzbekistan, or left altogether. Foreign direct investment (FDI) remains low; in 1997 only \$57 million, or less than \$3 per capita, entered the country as FDI. This is the lowest per capita rate in the former Soviet Union. This issue was addressed by the Government in May of 1998 when new legislation was introduced offering stronger protection for foreign investors.

The Government's policy since 1994 has been to try to encourage foreign investment through a series of presidential decrees and legislation that provides special tax breaks, guarantees and concessions to foreign investors and joint ventures with

foreign investors. All of these decrees and legislation are subject to the caveat, however, that their provisions are subject to existing Uzbek legislation, which significantly limits any positive impact they may have.

Uzbek authorities remain very interested in attracting U.S. investors to participate in trade and investment projects identified by the Government as high-priority for Uzbekistan, and representatives of U.S. companies that participate in such arrangements, such as Case Corporation, report that their business relationship is quite satisfactory.

POLITICAL CLIMATE

Political relations between the United States and Uzbekistan are strong, and Uzbekistan cooperates closely with the United States in international fora and on foreign policy, security, antiterrorism, and anti-narcotics issues. The United States formally recognized the Republic of Uzbekistan on December 25, 1991, and opened the U.S. Embassy in Tashkent in March 1992. There have been several exchanges of senior visitors, including a Karimov visit to the U.S. and meeting with President Clinton in June 1996, and visits to Uzbekistan by First Lady Hillary Rodham Clinton in November 1998 and Secretary of State Madeleine Albright in April 2000. Uzbekistan's relations with the U.S. have been tempered, however, by Washington's concerns regarding Uzbekistan's slow progress on democratic reform and its human rights abuses, as well as Uzbekistan's reluctance to undertake serious economic reforms.

Uzbekistan's Constitution, adopted on December 8, 1992, provides for a presidential system with separation of powers, freedom of speech, and representative government. In practice President Islam Karimov and the centralized executive branch that serves him dominate political life. First chosen President in a 1991 election that most observers considered neither free nor fair, Karimov had his stay in office extended to 2000 by a 1995 plebiscite. Parliament subsequently voted to make the extension part of Karimov's first term, thus making him eligible to run again in 2000. He was elected to a second term in January 2000 against token opposition. President Karimov makes virtually all-key decisions in the country, appoints and removes ministers and local officials at will, and clamps down on any opposition activity.

The Oliy Majlis (Parliament) is a 250-member rubber-stamp body consisting almost entirely of regional officials appointed by the President and members of parties that support the President. It meets only a few days each year, and has little power to shape laws. Despite constitutional provisions for an independent judiciary, the executive branch heavily influences the courts in both civil and criminal cases.

Uzbekistan has come under heavy criticism for its poor human rights record, and its repression of political opposition. Election and registration laws restrict the possibility of any real opposition parties arising or mounting a campaign. There is effective civilian control over the military. The Ministry of Interior (MVD) controls the police. The police and other MVD forces are responsible for most normal police functions. The National Security Service (NSS)--the former KGB--deals with a broad range of national security questions, including corruption, organized crime, and narcotics. The police and the NSS have committed numerous serious human rights abuses.

The main political factor affecting the business climate in Uzbekistan are the country's corruption networks and complicated clan-based power structures, many of which appear to profit from the distortions in the current economic system, and therefore resist reform. Another key factor is officials' inability to make any important decisions without presidential approval.

SOURCES OF FINANCING

The banking system in Uzbekistan remains closely controlled by the state through a complex set of regulatory actions, decrees, proclamations and practices. Most banking assets remain in state-owned or controlled banks, and most loans are directed by the government, financed through the Central Bank of Uzbekistan (CBU), and guaranteed by the Ministry of Finance. Government officials generally consider these loans to be risk-free despite the fact that the government has defaulted on its obligations several times since July 2000. Lack of reform in the banking system constrains banks' profits and limits their role as financial intermediaries, thus inhibiting the ability of citizens or private companies to obtain credit and other banking services.

Although the Central Bank's independence is guaranteed by Uzbek law, it is in fact nominal. In principle, the government has indicated that it wants to reform the banking sector, and has been working with the World Bank and the U.S. Agency for International Development (USAID) on strengthening its bank supervision capacity. While cooperation has been excellent, and the project has established a comprehensive framework for supervision, lack of true Central Bank independence makes full reform problematic. The Central Bank is unable to enforce bank regulations properly, leaving banks free to operate with little regard for applicable banking regulations, or the need to operate in a fiscally safe and sound manner.

Uzbekistan's state-owned National Bank of Uzbekistan for Foreign Economic Activity (NBU) functions as the financial gate between the Government of Uzbekistan and the rest of the world; it is the main channel for the inflow, distribution and servicing of foreign financing and investments. The NBU and a handful of other large state-owned banks, which serve largely as channels for government-directed lending, dominate Uzbekistan's banking sector. Uzbekistan also has several joint venture banks, including ABN Amro Bank, which have a large share of the foreign business market. Several private banks have a tiny but growing share of Uzbekistan's banking market, especially for small and medium enterprises (SMEs).

The IMF program in Uzbekistan has been in abeyance since 1996, limiting the extent to which international financial institutions can increase lending in support of economic development. Nonetheless the European Bank for Reconstruction and Development (EBRD), Asian Development Bank (ADB) and International Finance Corporation (IFC) have all extended credit lines for SMEs through state-owned banks such as the NBU, Asaka Bank, Promstroybank, as well as one private bank (Hamkorbank). Some of these banks have had access to foreign exchange to convert their clients' credit line payments, but most do not, leaving even profitable borrowers unable to repay their hard currency debts. Accordingly, most new credits are going to export-oriented ventures that will generate hard currency income for debt repayment. The EBRD and IFC also extend direct credits to private investors in Uzbekistan, and

have made some equity investments. Together with the NBU, they are minority shareholders in ABN-Amro Bank. The EBRD and IFC are potential participants in the government's privatizations of Uzbektelecom, Uzbekneftigaz, banks, and other enterprises.

The following agreements and U.S. agency programs underpin the financing of U.S. business activity in Uzbekistan:

- **The Bilateral Trade Agreement.** The 1994 agreement provides for Most Favored Nation (MFN) status for products of both countries, improved market access, and non-discriminatory treatment for U.S. goods and services in Uzbekistan and for Uzbek products in the United States.
- **General System of Preferences (GSP).** Also in 1994, Uzbekistan was granted GSP status from the United States, conveying nonreciprocal tariff preferences. Through this, 4,400 semifinished products and agricultural goods were exempted from U.S. import tariffs and customs duties.
- **U.S. Export-Import Bank.** The Export-Import Bank is open for short and medium term credits in Uzbekistan. Ex-Im will require an Irrevocable Letter of Credit or guarantee from the National Bank for Foreign Economic Activity of the Republic of Uzbekistan.
- **Overseas Private Investment Corporation (OPIC).** The OPIC agreement which allows OPIC to offer political risk insurance and other programs to U.S. investors in Uzbekistan was concluded in 1992 and is in force. This bilateral agreement authorizes OPIC to provide loans, loan guarantees, and investment insurance to American companies that invest in Uzbekistan.
- **U.S. Trade & Development Agency (TDA).** TDA is authorized to operate in Uzbekistan. TDA provides funding for U.S. firms to carry out feasibility studies and conduct other planning services related to major projects.

TELECOMMUNICATIONS

After gaining its independence, the Republic of Uzbekistan inherited numerous problems in its telecommunication industry. The modernization needs for the telecom sector were clearly outlined in the Uzbekistan law on telecommunications as well as in the national program for reconstruction and development of the telecommunication network (NPRDTN) in the Republic of Uzbekistan by the year 2010 adopted by the government of Uzbekistan (GOU) in 1995. The major points of NPRDTN included: installation of the Uzbek part of the large fiber optic line project (Trans-Asia-Project); complete digitalization within the country by year 2010; and the increase in telephone line density.

Before the country's independence, the telecommunication sector was a state monopoly. The first step towards structural change in the sphere of post and telecommunications was made when regional production communication departments were reorganized to enterprises of post and electrical communications. As a result, the number of independent enterprises and agencies has grown.

Transformed from the Ministry of Communications in 1997, the State-run Uzbek Agency for Post and Telecommunications (UAPT) is a major institution dominating the country's telecommunications market. UAPT supervises the State-owned Uzbektelecom that was formed from two holding companies, Mahaliy Telecom, which serves as the local services carrier, and Halkaro Telecom, the international and national long-distance carrier.

In 1995 the GOU adopted the "National Program for Reconstruction and Development of the Telecommunications Network". According to this program, investments in the sector would reach US\$672 million by the year 2010. By the end of this year, however, investments from the national budget will only cover 18-20 percent of the indicated amount. The GOU would like to cover the remainder with foreign investments and loans.

The first phase of the program, covering 1994-2000, was aimed at providing 400,000 telephone installations in Tashkent and the country's regional capitals. Digitalization was to reach 40 percent by the end of the first period. In 2000 the GOU plans to complete its share of the installation of the fiber optic line, known as the Trans-Asia-Europe project from China to Germany. As a result, the average line density per 100 people will only comprise 10.1 by year-end, 10.9 in 2005 and 13.4 by 2010. The increase in the number of international channels is projected to grow from 1,800 in 1995 to 3,300 by 2005. The second stage of the GOU's telecommunication modernization plan (2001-2005) calls for digital connections covering the country's rural areas and regional cities. The target for telephone density is 11 percent, with 70 percent being digital. Plans call for digitalization to be completed during the third stage, 2006-2010.

Wireless Communications

Wireless communications offer the most promising perspectives for the country's telecommunications market. The first cellular system came to Uzbekistan in 1992, when the Uzbek-US joint venture Uzdunrobita announced the commencement of its commercial operations. The company introduced the cellular services in Uzbekistan based on the NMT-450 standard. In 1992 the number of users quickly reached 100 and by the end of 1993 this figure tripled to 300. Since then, wireless communications have become the country's fastest growing telecom market segment. Despite the existing economic challenges in Uzbekistan the wireless communications provide a high level of profitability, low capital costs, and quick return of invested capital. Experts estimate the number of users of wireless communications will gradually increase. According to officials the number of cellular phones in Uzbekistan should reach 150,000 by the year 2010. They project that most of this increase will be financed by foreign investment. Extensive market research projects the total size of the cellular telephone market will reach at least 300,000 users.

The local cellular companies offer two standards: GSM 900 and Amps/Damps. There are a few prospective projects on channel division multiple access (CDMA) development, however this standard at present covers only a small percentage of the market. There are four companies using a GSM standard and two operators provide Amps/Damps services. The majority of the wireless equipment is imported from the United States, the European Union, and Asia.

The range of cellular services and prices varies widely. The existing competition among cellular providers is strong, which has resulted in a significant decrease of tariffs on communications services and installation. This in return, has allowed the number of potential customers to expand.

INFORMATION TECHNOLOGY

Hardware and Software

The local computer market has potential. Local computer specialists estimate the total market size at US\$30-40 million. The demand for Information Technology (IT) products is huge, but the majority of the population has yet to be able to afford to buy a PC due to the price. The following factors continue to keep the price high: hard currency convertibility; high duties and tariffs on the imported equipment; and low purchasing power. These create substantial barriers to the development of the IT industry. Recent market surveys have shown that most small and medium size companies show a 10–15 percent profit margin from overall sales.

There are more than 200 small and medium sized computer companies, including individual businesses working on a local license, in the Uzbekistan computer market. Approximately 10 percent of hardware companies work successfully as distributors or partners of US companies.

Effective September 1, 1999, the GOU shut down the activities of different cultural and athletics funds, which had the privilege of tax-free status for profit. Using these types of fund-channels, a large number of hardware companies in Uzbekistan had opened branch companies to avoid high taxes and duties. IT market specialists estimate that between September 1999 and April 2000, more than 60 percent of the market shifted from medium and large importing companies to small private entrepreneurs.

This past year, computer companies experienced strong market fluctuations. After the GOU equalized the hard currency official and black market exchange rates, most of the IT companies were hit hard. Yet another new 10 percent excise tax was imposed on October 1, 2000, which included readymade computer products and office equipment resulting in the further deterioration of the pricing situation of computer equipment. In the past, companies avoided payment of high taxes by lowering original costs of computer equipment on the invoice. However, starting this year, local customs outlined a new procedure for estimating the equipment cost. The cost is now estimated through a review of the existing local market price of similar products, which generates more tax revenues than the old method.

The lowest priced locally assembled computer costs US\$450. There are an estimated 350,000 computers in the country. This is a very low estimate for a country with more than 24 million inhabitants. An average computer company sells 100 to 150 PCs monthly. Most of the large purchase contracts go to corporate clients. Hewlett Packard is an accepted leader in the PC and peripherals market.

Based on a review of Uzbek computer companies, the following new trends exist in domestic information technology market: multimedia computers; business network

integration and turnkey solutions; network equipment; and refurbished computer parts.

The growing number of domestic PC owners, larger than ever Internet penetration, and further upgrades by corporate enterprises facilitate gradual growth of the Uzbekistan software market. Large enterprises, banks and government agencies increasingly use system-integrated solutions and packaged software. Local software companies indicate an increased demand for enterprise resource planning (ERP) systems, accounting, banking software, enterprise, and office security systems. The demand for automated planning systems by medium size companies grows annually. Large industrial factories and enterprises realize the need for modernization of its corporate information network, management information systems, and cooperation with domestic and NIS software companies to determine the primary tasks for automatization. The growth of Internet users and local web sites reflects the further need for internet-related software applications. Finally, development of smart cards for banking and e-commerce has the greatest potential.

The negative side of the Uzbekistan software market is the dominance of illegal software. As elsewhere in NIS countries, pirated software accounts for a significant percentage of overall software products. Private users, small and medium businesses, corporate clients and government agencies use illegal products.

Best prospects for U.S. software are business accounting systems or ERP, which are largely in demand by medium and large size enterprises. There is an increase in demand for specially designed software applications in the financial and trading spheres.

Internet

The popularity and overall growth of the Internet network in Uzbekistan is increasing with an unprecedented pace. Some indicators include: the organization of the first National Internet Festival; a large and growing number of Internet public access centers and cafes; a drastic increase of local ISPs; and the appearance of domestic web-shops.

Aiming to expand the utilization of modern technologies and the Internet network in all spheres of the economy, science and education on May 23, 2001, the Cabinet of Ministers announced a resolution on measures for the organization of a program for the development of the computer and information technologies from 2001 to 2005, and provisions for wide access to the international data systems of the Internet. According to the resolution, Cabinet of Ministers will create a special working group that will develop the program. The working group will provide the following: thoroughly analyze the level of organization and development of the computer and information technologies in Uzbekistan; and assess the level of education and training of personnel involved in development of computer technologies, software and programming. Most importantly, the program calls for the provision of wider access to the Internet network for education and scientific institutions, domestic enterprises and organizations. The program will involve movement towards localization of the computer and computer related equipment production. The Uzbek Cabinet of Ministers proposed to create a special fund for the support of the development of the information technologies, which will include domestic and international sponsors.

It is expected that the Uzbekistan Internet market will move towards eventual consolidation. As a result of this process the Uzbek market will generate a few leading brands owned by IT companies providing a range of Internet-related services, such as Internet access, content delivery, free email, web-hosting and E-Commerce. In the future, the leading Internet brands will follow a strategy of combining ISP and portal activities. Market research shows that companies involved in the Internet services market such as companies working in Web-hosting, Web-design and system integration will succeed in the long term.

The Uzbekistan's information technology infrastructure has a significant potential for growth. According to local estimates, there are more than 25,000 registered users, and approximately 150,000 users, who have access to the Internet. The number of ISPs has reached 39. Local experts expect the number of domestic Internet users to grow steadily over the next few years, exceeding the rate of growth for GNP.

Uzbek companies are slowly utilizing Internet services showcasing their information on the web, and are reviewing the possibility of further expansion into e-commerce, web advertising and marketing, once the opportunity avails itself. Over 1,000 local web sites are registered on the worldwide web-network. More than 30 percent of them belong to state and non-commercial organizations, 45 percent are commercial sites, 10 percent are information sites and 15 per cent are entertainment or other sites.

The GOU plans to expand utilization of the Internet to the regions. Understanding that the largest density of Internet users is concentrated in Tashkent and other regional centers, it is expected that further growth among Internet users will occur in the outlying regions. Statistics shows that Internet penetration will hit 1 percent by the end of 2001.

The Internet services market statistics show that the provision of Internet access has been the Uzbek Internet market's major revenue generator. According to local IT specialists estimates, Internet access accounted for almost 90 percent of all Internet revenues in 2000. This situation originates from a few important factors including: an overall increase of popularity of Web browsing; relatively high Internet access tariffs; fast recoup of initial expenses; and lack of per-minute billing for local calls.

The growing number of local ISPs shows that the provision of Internet service is a profitable business in Uzbekistan. The majority of ISPs are located in Tashkent. The major data transmission providers are UZPAK, Naytov, Uzneta, Eastlink, CCC, GlobalNet, and BCC. Some of the standard Internet services include dial-up, leased-line connections, e-mail, DNS service and web design.

At this stage the Uzbekistan's E-Commerce faces a few challenging problems including logistics, low Internet penetration, and the population's low purchasing power. Settlement and payment issues remain very serious. Uzbekistan, like most NIS states, has very low credit card penetration. In fact, credit card penetration is actually much lower since almost all-banking cards issued by Russian banks are debit cards. This limits the borrowing potential of Uzbekistan Internet users and increases fraud risk. Therefore, until the use of special Internet payment cards is established, cash will remain the main payment option for Internet transactions. This creates a problem in processing large transactions that require relatively large sums of cash, thus raising security risks. At the moment, 100 percent of all transactions concluded over the Internet are settled in cash.

